Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)	**CC Docket No. 01-338**
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996	)	**CC Docket No. 96-98**
Deployment of Wireline Services Offering Advanced Telecommunications Capability	)	**CC Docket No. 98-147**

REPLY COMMENTS OF TALK AMERICA INC.

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Dated: July 17, 2002

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> *Under the local-competition provisions of the Act, Congress called for ratemaking different from any historical practice, to achieve the entirely* ***new objective of uprooting the monopolies*** *that traditional rate-based methods had perpetuated...A leading backer of the Act in the Senate put the new goal this way:*
>
> *"This is extraordinary in the sense of telling private industry that this is what they have to do in order to let the competitors come in and try to beat your economic brains out...[T]his legislation says you will not control much of anything.* ***You will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of the Bell operating companies network*** *that is at least equal in type, quality and price to the access [a] Bell operating company affords to itself."*
>
> *Opinion of the Supreme Court of the United States, Verizon Communications, Inc. v. Federal Communications Commission, 122 S. Ct. 1646, 1660 (May 13, 2002).*

I. Executive Summary

On May 13, 2002, the Supreme Court of the United States issued an opinion in *Verizon Communications Inc. v. FCC* that leaves little room for doubt about the intent of the local competition provisions of the Telecommunications Act of 1996:[1] Congress intended to "uproot the monopolies," to "reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers," and to "give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property."[2]

It is against the backdrop of the Supreme Court's timely interpretation of the Act, as well as a subsequent decision by the U.S. Court of Appeals for the District of Columbia Circuit[3] remanding the existing federal unbundling rules for reconsideration, that the Federal Communications Commission ("FCC") must evaluate the comments submitted in this Triennial Review of the network unbundling obligations that the Act imposed on incumbent monopoly local exchange companies ("ILECs").

The Supreme Court could hardly have been clearer in describing the intent of the Act: Short of confiscating ILEC property (an allegation that the Supreme Court noted is very difficult to sustain), the Act intended to give aspiring competitors *every possible incentive* to enter the local telephone markets. And, it intended for competition to be so effective that it would uproot the monopolies built on the back of traditional regulation, by allowing the competitors to use the ILECs' own networks.

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104 110 Stat. 56, codified at 47 U.S.C. §§ 151 *et seq* (the "Act").
[2] 122 S. Ct at 1646, 1660-1661 (2002) ("*Verizon v. FCC*").
[3] *United States Telecom Ass'n v. Federal Communications Comm'n,* 290 F.3d 415 (DC Cir. May 24, 2002) (*"USTA v. FCC").*

Judging by their comments in this proceeding, the ILECs undoubtedly do not agree with this interpretation of the Act. In their efforts to convince the FCC to restrict competitors from leasing their network elements, they ignore the decisive competitive advantages that the incumbents continue to enjoy in the local markets, the practical difficulties that competitors face in attempting to overcome those advantages, and the incentives that the Act intended to give competitors to venture into those markets in spite of the uphill battles they would face.

The positions that have been taken by the incumbents in this case are not surprising. Naturally, they seek to retain their monopoly positions in the local markets by restricting competitors' ability to lease network elements that most competitors currently rely upon to compete in those markets. The opposing comments offered by most competitive carriers are likewise not surprising. They seek to retain and preferably expand the network elements available to them so that they can attempt to gain a toehold in the local markets and, ultimately, carry out the Act's goal of uprooting the monopolists. While the competitors' private objectives are no more altruistic than the ILECs', the outcome of their success will benefit the public interest by bringing to consumers the benefits of competition. In contrast, if the ILECs succeed, consumers and the public interest will receive no benefits, but will instead suffer from the higher costs and prices, fewer choices, lack of innovation, and inefficiencies that come from monopolists who have become increasingly and perhaps irreversibly unregulated.

In evaluating these two competing interests, the FCC should recognize that the Act requires it to weigh in favor of the competitive interests—as the Supreme Court said, to "give aspiring competitors every possible incentive to enter local retail telephone markets."[4] Unduly restricting the availability of ILEC network elements at this still-nascent stage of competitive development, particularly in the residential market, would not be consistent with that intention, as it would both prevent new competitors from entering the markets and drive existing competitors out.

These impacts of restricting access to UNEs are not mere speculation on Talk America's part. Competitors who rely on UNEs to compete in the local markets will be irreparably harmed if the FCC takes steps to eliminate or phase out the availability of critical UNEs. This is particularly true for competitors, like Talk America, who compete predominantly for residential customers and small business customers in the mass market. Despite the ILECs' unsupported claims to the contrary, it is economically and operationally infeasible for competitors to compete in the mass market today on a widespread basis without access to ILEC loop, switching, transport, signaling, operational support systems, and databases. And, until competitors can develop customer bases of sufficient density utilizing the UNE entry strategy, they will remain irreparably impaired in their ability to compete without those network elements.

Moreover, the ILEC networks were built and developed on the backs of ratepayers over a period of nearly one hundred years, during most of which time consumers had no choice but the ILECs for their telecommunications services, and the ILECs' bore little if any risk in making investments to build the telephone network. To now deny ratepayers the benefits of competitive choice by restricting CLECs' access to those ratepayer-funded network elements would be grossly unfair to consumers, inconsistent with the Telecommunications Act, and bad public policy.

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[4] *Verizon v. FCC* at 1661.

Contrary to the ILECs' arguments, limiting the availability of UNEs will not stimulate CLECs to invest instead in their own facilities—if no other economically feasible alternative exists, it will simply drive them out of business. Today's capital markets will not provide funds for investment in facilities until facilities-based competition is shown to be a near-term profitable endeavor. As FCC Chairman Powell recently recognized upon his appointment to President Bush's Corporate Fraud Task Force: "There is a severe capital crisis putting a tremendous strain on the telecommunications industry."[5] No one could reasonably argue the fact that it is the CLECs in the industry, not the ILECs, who have been the most severely impacted by this capital crisis, due to the CLECs' substantially higher business risk. This higher risk stems from several factors, the most important of which are: (1) unlike ILECs, CLECs do not have large, entrenched customer bases, many of whom remain largely captive to the ILEC; (2) CLECs do not have the economies of scale and scope that ILECs enjoy by virtue of their ubiquitous, ratepayer-funded local networks; (3) CLECs (even those with some facilities) are dependent on the ILECs for underlying network facilities, operation support systems, and databases; and (4) the regulatory uncertainty in the telecommunications industry imposes greater risk on CLECs than on ILECs. The elimination or restriction of UNEs as a market entry vehicle will only worsen the capital crisis facing the CLEC sector of the industry. It will not, as many ILECs claim, make facilities-based entry any more attractive or justifiable than it is today. To the contrary, it will preclude facilities-based entry by eliminating the means by which competitors can

[5] "FCC Chairman Michael Powell Appointed to President Bush's Corporate Fraud Task Force," Press Release issued on July 9, 2002, www.fcc.gov.

now attempt to attain sufficient market penetration and density to make facilities-based competition economically rational in the future.

The ILECs are also wrong when they claim that competitors have no incentive to invest in their own facilities while UNEs remain available from the ILECs. Any CLEC would prefer to reduce and ultimately eliminate their reliance on ILEC facilities and support systems rather than perpetuate this dependency. It is almost incomprehensible that the ILECs could be so cavalier as to argue that CLECs would want to indefinitely rely upon their largest and most successful retail competitors for the facilities and back office systems that form the very core of the CLECs' businesses. No company would willingly accede to reliance on its most formidable competitor for its key production inputs, were it not absolutely necessary. When it becomes economically and operationally feasible to compete using its own facilities or those of a more hospitable third party and capital becomes available to do so, Talk America certainly intends to make a hasty exit from its uncomfortable, yet currently necessary, reliance on ILEC facilities and support systems.

A granular market-specific analysis is needed to determine when and where such an exit is operationally and economically feasible, and thus, when and where ILEC network elements need no longer be subject to unbundling requirements. Such a granular analysis likewise appears to be required by the recent decision by the D.C. Circuit Court of Appeals, which remanded the FCC's current unbundling rules back to the FCC for reconsideration due, in large part, to the overly broad, universal unbundling requirements that it said the FCC had imposed through those rules.[6] The market-specific analysis that

[6] On July 8, 2002, the FCC and the United States Department of Justice filed a Petition for Rehearing or Rehearing En Banc of *USTA v. FCC* (filed July 8, 2002) (hereinafter "*Petition for Rehearing*").

is called for will require extensive participation by the state regulatory commissions, who are in the best position to gather the requisite information and fully evaluate the demand, costs, and other market characteristics that must be weighed in assessing the impairment standard.

II. Introduction

Talk America Inc. ("Talk America") is a competitive local exchange company ("CLEC") that provides local and long distance voice telecommunications predominantly to residential customers. The Company's current local customer base includes nearly 245,000 access lines spread across 25 states, more than 85% of which are provided to residential subscribers. The vast majority of Talk America's lines are provisioned using the UNE Platform ("UNE-P), and it is only through the availability of that platform that the Company has been able to offer a viable competitive alternative to these subscribers—an outcome that has helped advance the competitive benefits that the Act sought to achieve.

By employing this entry strategy, coupled with aggressive cost cutting through the development and deployment of a variety of productivity-enhancing "back office" systems and processes, Talk America has achieved something that very few CLECs have: profitability. Since its entry into the local markets in mid 2000, Talk America suffered net operating losses until the fourth quarter of 2001, when it "turned the corner" and began to produce modest profits. The Company's ability to continue its development into a strong competitive force in the residential local exchange markets, and to realize its goal of deploying competitive facilities in the future in order to further strengthen its competitive position, requires the continued availability of the UNEs that constitute the UNE platform until such time that: (1) the Company can economically justify deployment of its own or use of third-party competitive facilities on a market-specific basis; (2) the ILECs are capable of seamlessly transitioning Talk America's current customer base and future customers to competitive facilities; and (3) Talk America can obtain the capital necessary for the transition to its own or third-party facilities. That time has not come.

Talk America submitted Initial Comments in this proceeding on April 5, 2002, urging the FCC not to reverse any of the pro-competitive components of the regulatory scheme that it adopted following passage of the Act.[7] That scheme, while not perfect, has allowed companies like Talk America to begin making competitive inroads into the local markets that remain overwhelmingly dominated by the incumbent LECs. One of the most critical of the pro-competitive elements mandated by the Act and implemented via FCC rules is the ability for competitive carriers to lease unbundled network elements from incumbent LECs.

As discussed in Talk America's Initial Comments, the only way to foster the development of facilities-based competition for the mass market, and thereby ultimately eliminate the bottleneck that allows ILECs to sustain their monopoly power in local markets, is to allow CLECs who have employed a UNE entry strategy to obtain a scale sufficient to provide them with economic incentive to deploy their own facilities. Competition in the mass market has clearly not developed to that point, and CLECs such as Talk America who are attempting to compete in that market are not in a position to

[7] *See generally* Initial Comments of Talk America Inc. *See also In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *and Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Notice of Proposed Rulemaking, 15 FCC Rcd 22709 (rel. Dec. 20, 2001) ("*Triennial Review NPRM*" or "*UNE Triennial Review*").

build their own networks, nor can they practically or economically purchase or lease critical network components from non-ILECs, even if such elements were readily available.

Accordingly, any changes in FCC policy that restrict or eliminate access to the ILEC UNEs or UNE combinations would severely impair Talk America's ability to provide telecommunications services to its current and prospective residential and small business customers, in contravention of the Act. Talk America therefore urged the FCC in its Initial Comments to avoid any such changes, and instead to take positive steps to expand and more stringently enforce the ILECs' unbundling obligations.

Not surprisingly, the FCC's Triennial Review has attracted interest from seemingly every incumbent and competitive telecommunications company in the country, most of whom filed comments, as did many state regulatory commissions and a variety of consumer and other interest groups. The level of interest and volume of comments filed speaks to the critical nature of the issues the Commission is considering in its review, and the high stakes involved for private businesses, individual consumers, industry and the economy in general, and the overall public interest.

Following the early April 2002 submission of initial comments by Talk America and other parties, two significant court decisions were issued with important implications, if not a direct bearing, on the issues under consideration in the Triennial Review. First, on May 13, 2002, the Supreme Court of the United States issued a decision in *Verizon Communications v. FCC* ("Supreme Court Decision"), in which it upheld the Total Element Long-Run Incremental Cost ("TELRIC") standard adopted by the FCC for setting UNE prices as well as the FCC's UNE combination rules.[8] Less than two weeks later, on May 24, 2002, the United States Court of Appeals for the District of Columbia Circuit issued a decision in *United States Telecom Association v. FCC* ("D.C. Circuit Decision"),[9] in which it vacated and remanded for further consideration the FCC's *Line Sharing Order*[10] and remanded (but did not vacate) the FCC's 1999 *Local Competition Order,*[11] which identified the minimum list of network elements that ILECs were required to unbundle. On June 8, 2002, the FCC and the United States Department of Justice sought Rehearing or Rehearing En Banc of the D.C. Circuit Decision.[12]

The additional granular analysis demanded by the D.C. Circuit Decision in evaluating the impairment standard clearly calls for greater involvement by state regulatory agencies. As discussed more fully below, it is not feasible for the FCC alone to undertake the market-specific analysis of retail rates, facilities costs, competitive alternatives, and other factors that is required under the D.C. Circuit's interpretation of the Act. Even in the absence of that decision, Talk America believes that granular, market-specific analyses conducted through the state regulatory commissions are necessary before concluding that non-impairment now exists with respect to any of the UNEs currently available under the FCC and/or state rules and orders.

With its limited resources, Talk America cannot hope to respond to the thousands of pages of comments that have been submitted in the proceeding, nor to every issue

[8] *Verizon v. FCC.*
[9] *USTA v. FCC.*
[10] *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* 14 FCC Rcd 20912 (1999), on reconsideration, 16 FCC Rcd 2101 (2001)
[11] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd 3696 (1999)
[12] *Petition for Rehearing.*

raised by the Supreme Court and D.C. Circuit Decisions. For an overall response to the initial comments and the implications of those court decisions, Talk America joins the Reply Comments submitted by the UNE Platform Coalition, and hereby incorporates by reference those Reply Comments. Talk America's separate Reply Comments focus on the key factors that should be considered in determining whether the unavailability of certain network elements would "impair" a competitive carrier's ability to provide the services it seeks to offer. Given Talk America's focus on the residential and small business market, its comments concentrate on the impairment standard with respect to the provision of competitive services to that customer base. We will respond primarily to arguments presented in the initial filings of the former Regional Bell Operating Companies ("RBOCs"), BellSouth, Verizon, SBC, and Qwest, who control the bottleneck local exchange facilities in the service territories where Talk America operates.

Each of the RBOCs submitted separate comments that relied upon a jointly sponsored UNE Fact Report 2002 for drawing virtually uniform conclusions about the current state of the telecommunications market and to support their contentions that CLECs would not be impaired if the network elements that the incumbent's are obligated to provide under the Act were now withheld from competitors. Talk America will show that these contentions are based on misleading "facts" and a misrepresentation and/or misunderstanding of the financial, operational, and practical situation confronting CLECs attempting to compete in the mass market.

We will show that there are overwhelming cost and operational factors that currently prevent competitors like Talk America from replacing elements included in UNE-P with self-provisioned or third-party facilities to provide competitive services to a residential/small business customer base. Consequently, if the FCC restricts the availability of the UNE-P method of competitive entry by prematurely eliminating the ILEC obligation to provide some or all elements of that combination, the small competitive inroads that competitors like Talk America have made in the residential/small business market will be irreparably reversed, contrary to the goals of the Act.

III. Impairment Analysis[13]

A. Current "Impair" Standard

In its 1999 *Local Competition Order*, the FCC defined the "impair" standard that would apply to non-proprietary network elements as follows:

> The incumbent LECs' failure to provide access to a non-proprietary network element "impairs" a requesting carrier within the meaning of section 251(d)(2)(B) if, taking into consideration the availability of alternative elements outside the incumbent's network, including self-provisioning by a requesting carrier or acquiring an alternative from a third-party supplier, lack of access to that element *materially diminishes* a requesting carrier's ability to provide the services it seeks to offer.[14]

The FCC considered several factors in evaluating whether a requesting carrier's ability to provide service would be materially diminished without access to components of the incumbent LECs' network, including "the cost, timeliness, quality, ubiquity, and operational issues associated with use of the alternative."[15] Further, because the Act requires the FCC to consider the necessary and impair standards "at a minimum," the

[13] Talk America's Comments focus on the "impair" standard in Section 251(d)(2) of the Act, rather than the "necessary" standard, because the network elements that it requires for serving its current and prospective customers are not proprietary elements that would invoke the latter standard.
[14] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd 3696 (1999) (the "*Local Competition Order*") at par. 15.
[15] *Id.*

Commission determined that it should also take into account additional factors when determining the ILEC unbundling obligations: (1) whether the unbundling requirement is likely to promote rapid introduction of competition in all markets; (2) whether the obligation will promote facilities-based competition, investment and innovation; (3) the extent to which regulatory obligations can be reduced as alternatives to the ILECs' facilities become available; (4) whether the unbundling requirements will provide uniformity and predictability for new entrants and market certainty in general; and (5) administrative practicality of the unbundling requirements.[16]

The FCC identified seven network elements that met the impairment standard, based on its consideration of all of these factors: (1) loops; (2) subloops; (3) network interface devices; (4) local circuit switching, except in certain large markets for customers with more than four lines; (5) interoffice transmission facilities; (6) signaling and call-related databases; and (7) operations support systems. With the exception of the circuit switching exemption in certain markets, the FCC determined that these network elements must be unbundled on a national basis.

B. D.C Circuit Decision

In remanding the FCC's *Local Competition Order* for further consideration of ILEC unbundling obligations, the D.C. Circuit identified two major objections to that decision and the ensuing federal rules. First, it objected to the FCC's adoption of "a uniform national rule, mandating the element's unbundling in every geographic market and customer class, without regard to the state of competitive impairment in any particular market."[17] Second, the Court indicated that the cost disparities considered by

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[16] *Triennial Review NRPM*, 15 FCC Rcd at 22710, ¶ 9.
[17] *USTA v. FCC* at 422.

the FCC in assessing impairment were too broad, reflecting disparities that could exist between incumbents and new entrants in any industry, and therefore were not "reasonably linked to the purpose of the Act's unbundling provisions."[18] The Court indicated that the FCC should consider whether or not the cost characteristics of a network element make it "unsuitable for competitive supply," rather than just materially diminishing the entrant's ability to offer the service it seeks to provide.[19] On July 8, 2002, the FCC and the U.S. Department of Justice asked the D.C. Circuit for Rehearing or Rehearing En Banc of the May 24, 2002 decision.

Pending any further review, the D.C. Circuit Decision requires the FCC to conduct a far more granular analysis of market characteristics in its development of rules for determining when, where, and to what elements the Act's unbundling obligations should apply. The Court's decision suggests that the FCC may need to evaluate at least the following factors: (1) retail price/cost disparities in specific markets resulting from state commission price regulation; (2) deployment of competitive facilities in specific markets; (3) the effect of its impairment standard on incentives for facilities-based competition and innovation; and (4) whether economies of scale with respect to specific network elements (in specific markets) are such that competitive supply of the facility would be a wasteful duplication of resources, or whether they reflect normal cost disparities between incumbents and new entrants that occur in any industry.

C. Need for State Participation in Establishing Unbundling Obligations

It is impossible within the timeframe established for comments in this Triennial Review for any party or group to present evidence that would be sufficiently thorough

[18] *Id.* at 9.
[19] *Id.*

and detailed for the Commission to undertake the type of granular analysis apparently contemplated by the D.C. Circuit Court. In fact, given the market-specific nature of this analysis, Talk America respectfully suggests that the FCC is not in a position to develop and analyze the necessary evidence and draw reasoned conclusions regarding specific future ILEC unbundling obligations without substantial participation by the state regulatory commissions. The state commissions are in a far better position to fully scrutinize the factors the D.C. Circuit identified as important in considering the ILECs' unbundling obligations and many have expressed their readiness to undertake that effort.[20]

For instance, the states have jurisdiction over the retail rates charged by both incumbents and new entrants, and have or can gather information regarding the relationship of those rates to the underlying costs of serving urban versus rural and

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[20] For instance, in its April 2002 Comments in this proceeding, the Georgia Public Service Commission stated:

> the GPSC believes that it is uniquely situated to evaluate Georgia specific factual issues in order to make decisions about the degree to which local switching and other network elements should be unbundled by the incumbent LECs in Georgia, in order to achieve the pro-competitive goals of the Act and of Georgia law. While we welcome the FCC's effort through the instant proceeding to reexamine the unbundling obligations of the incumbent LECs, we urge the FCC not to attempt to limit the ability of individual state regulatory commissions to impose unbundling obligations upon the incumbent LECs within their jurisdiction, as long as those obligations are consistent with the requirements of Section 251 of the 1996 Act and with the policy framework set out by the FCC in its UNE Remand Order. Any attempt to constrain a state commission's ability to require unbundling where the factual circumstances demonstrate its necessity would clearly undermine the pro-competitive goals of the Act. (Initial Comments of the Georgia Public Service Commission.)

Similarly, in their initial filed comments in this proceeding, the California Public Utilities Commission, the Florida Public Service Commission, the Illinois Commerce Commission, the Indiana Utility Regulatory Commission, the Kansas Corporation Commission, the Louisiana Public Service Commission, the Massachusetts Department of Telecommunications and Energy, the Michigan Public Service Commission, the New York Department of Public Service, the Public Utilities Commission of Ohio, the Oklahoma Corporation Commission, the Pennsylvania Public Utility Commission, and the Public Utility Commission of Texas all argued in support of a strong and active state role in determining market-specific network unbundling requirements within their respective states.

business versus residential markets. The state commissions can also better assess the extent to which alternative facilities are deployed in specific markets and whether or not the existence of such alternatives reduces or eliminates the need for ILEC unbundling of specific network elements. Likewise, because of their closer proximity and relationship to the consumers ultimately impacted by the unbundling decisions and their factual understanding of the nature of competition within their respective states, state regulators are in a far better position to evaluate many of the factors beyond impairment that the FCC deemed important in its UNE Remand Order, such as the extent to which unbundling will lead to the rapid introduction of competition, or, conversely, whether a retraction of unbundling requirements would harm competition and consumers.

Further, the FCC's procedural processes, which work well for the type of broad policymaking inquiries normally undertaken by the FCC, are not well suited to the detailed, fact-finding inquiry that is required to address the issues raised by the D.C. Circuit Court. State commission procedures, which provide for discovery, testimony and cross-examination of sworn witnesses, as well as other legal processes that give all affected parties adequate due process, are far more suited to the task at hand. Because any changes that will affect the availability of existing UNEs to competitive carriers will have profound impacts on the rights of specific carriers, as well as the industry as a whole, it is critically important that the proceedings undertaken to consider such changes protect the due process rights of all affected parties and that the evidence supporting or opposing changes to the current unbundling obligations is subject to the highest level of scrutiny possible.

Most of the state commissions that submitted initial comments in this proceeding supported state-specific determinations of the ILEC unbundling obligations even prior to the D.C. Circuit Court's Decision. The granular analysis that appears to be demanded by that decision makes the argument for active state participation in the determination of unbundling obligations even more compelling. While the FCC should continue to provide guidance to the states regarding the impairment standard and should retain a minimum list of elements to which the unbundling obligations of the Act should presumptively apply, the states should undertake the granular analyses necessary to determine market-specific unbundling obligations, just as they now establish state-specific UNE prices based on the FCC-mandated Total Element Long Run Incremental Cost methodology.

Neither Talk America nor any other party is in a position in this FCC proceeding to unilaterally present the kind of market-specific analysis of impairment and other factors that is compelled by the D.C. Circuit Court's remand of the FCC unbundling rules. In the sections that follow, however, we examine some of the key issues raised by the court and show why the analysis sponsored by the RBOCs in their initial comments fails to demonstrate that ILEC unbundling obligations should be lifted at this time, particularly for elements used by competitors serving the residential and small business markets.

D. Existence of Alternative Facilities

One of the D.C. Circuit Court's criticisms of the FCC's establishment of a uniform national list of UNEs is that the FCC "never explains why the record supports a finding of material impairment where the element in question—though not literally ubiquitous—is significantly deployed on a competitive basis in those markets where there is no reason to suppose that [retail] rates are artificially low."[21] In their initial comments in this proceeding, the RBOCs similarly claim that CLECs are not impaired in their ability to provide services without access to switching, loops, and transport, because of the presence of alternative facilities in certain locations. Further, they argue that, because some competitors are serving some customers in some locations using their own switching and/or loop facilities, impairment must not exist for any competitor.

Contrary to the RBOCs' position, there are sound arguments and strong evidence to support a finding of impairment, even where third-party facilities may be present in specific markets. If the presence of alternative facilities is to be used as a test for impairment, the analysis must be conducted on a market-specific basis, and must consider all of the factors relevant to a competitor's ability to provide the services it seeks to offer. The focus of Section 251(d)(2) is on the specific requesting competitor and the particular services it want to offer. Therefore, it is irrelevant in considering Talk America's UNE requirements for providing competitive voice telephone services to the mass market whether or not other CLECs seeking to provide service to large businesses are impaired without access to unbundled switching or shared transport. A more granular approach is required. Certainly, the mere presence of third-party facilities in some markets is not sufficient to judge the impairment standard.

The RBOCs' "evidence" regarding alternative facilities, as presented in the 2002 UNE Fact Report, is not compelling, because it fails to consider the economic and operational factors that confront particular CLECs when they seek to offer telecommunications services in specific markets. These factors determine whether or not

[21] *USTA v. FCC* at 422.

a CLEC is impaired without access to UNEs. For instance, in their jointly sponsored UNE Fact Report 2002, the RBOCs report that, "[t]oday, CLECs operate approximately 1,300 *known* local circuit switches."[22] However, the presence of these circuit switches in various locations does not demonstrate that CLECs are unimpaired without access to incumbent switching, for several reasons, as described below.

1. No Obligation for Competitors to Offer Wholesale Switching

Competitive carriers (non-ILECs) are not obligated under the Act or any regulatory law or rule to offer their switching facilities for lease to other carriers, most such carriers did not install switches for the purpose of offering competitive capacity in the wholesale market, and most do not do so. In fact, Talk America is unaware of any competitive carriers who could and would be willing to provide it with competitive switching capacity under acceptable terms in specific markets where Talk provides service to residential and small business customers.

2. No Competitive Wholesale Switching Market

Even if competing carriers did make their switching capacity available to other competitors, there is no guarantee that they would offer it at competitive rate, which, by definition, would be no higher than the ILEC's TELRIC-based switching rates.[23] Only if a truly competitive wholesale switching market were to develop, resulting in prices no higher than TELRIC (and assuming other cost and operational issues could be overcome), would non-switch CLECs be able to obtain access to alternative switching

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[22] UNE Fact Report 2002, at I-2 (April 2002), submitted in *Triennial Review NPRM, 15 FCC Rcd 22709.* Emphasis in original ("UNE Fact Report 2002").

[23] The Supreme Court found in *Verizon v. FCC* that "TELRIC does not assume a perfectly efficient wholesale market or one that is likely to resemble perfection in any foreseeable time" and noted that "the FCC has of its own accord allowed for inefficiency in the TELRIC design…." *Id.* at 1668-69 (Since rates in a perfectly competitive market reflect costs of the most efficient methods of production, TELRIC-based rates, by definition, exceed competitive rates.).

facilities at rates that would allow them to offer competitive telephone services in the retail mass markets. Such a competitive wholesale switching market has clearly not developed. In fact, while the RBOCs offer a list of locations where they claim competitive switching facilities are available, they provide no evidence as to whether capacity from those switches is available on the market to other competitors or, if it is, the prevailing market prices for that capacity and the relationship of those prices to the TELRIC-based UNE switching prices set by state commissions for ILECs. The RBOCs did not offer such evidence because a wholesale switching market for the provision of local service simply does not exist.

3. Operational/Cost Obstacles

Even if competitive switching capacity were available to CLECs on the wholesale market, many operational obstacles would have to be overcome before it could realistically replace the UNE-P provisioning method, particularly for CLECs, like Talk America, who serve the residential market. One of the most daunting obstacles in transitioning from UNE-P provisioning to self-provided or third-party switching for the provision of service to residential customers is the physical transfer of those customer's lines from the ILEC switch to the competitive switch. This transfer would require a "hot cut" for each customer's line, which currently involves a very labor-intensive process requiring extensive coordination between the CLEC and ILEC.[24] While the RBOCs attempt to demonstrate their improved proficiency in performing hot cuts with graphical presentations of the percentage of hot cuts "completed on time"[25] this information is

[24] For a detailed explanation of the hot-cut process, *see* Initial Comments of Z-Tel Communications, Inc., Attachment 6.
[25] *See* UNE Fact Report 2002, Appendix H.

meaningless in evaluating their ability to perform hot cuts for the large volumes of orders placed daily by a competitor, such as Talk America, which serves residential customers.

The RBOCs' hot cut performance, even if it has improved over time, reflects relatively small numbers of cuts typically performed for competitors serving larger business subscribers. There is no evidence to show and no reason to expect that the RBOCs could efficiently and seamlessly perform hot cuts on a forward-going basis for competitors who submit large volumes of orders to switch residential subscribers. To the contrary, under the current hot cut method of transferring customers from one local carrier to another, it is physically impossible for ILECs and CLECs to coordinate seamless customer transfers for the high volumes of orders processed by CLECs competing in the mass market.

The problem would be exacerbated for transferring the existing base of a competitor's subscribers in a cost-effective and operationally seamless manner. No RBOC has demonstrated how this could be done if switching is removed from the list of required UNEs. Yet, a seamless, low-cost method of switching local customers from one carrier to another, comparable to the Preferred Interexchange Carrier ("PIC") process that has developed in the long distance market, is critical to the ability of CLECs to effectively compete in the mass market.

In its initial comments in this proceeding, the New York Department of Public Service ("New York DPS") accurately and succinctly recognized the hot cut problem as one of the "major issues that hamper the development of facilities-based competition,"[26] and concluded that "[u]ntil hot-cuts can be performed in much greater volumes, CLECs' lack of access to the UNE-P will materially diminish their ability to provide local

[26] Initial Comments of the New York State Department of Public Service at 3.

service."[27] The New York DPS noted that Verizon provisioned an average of about 205,000 orders per month via UNE-P during 2000 and 2001, and performed an average of only 4,700 hot-cut orders per month during 2001.[28] It recognized that "if all of the 205,000 UNE-P orders were to become UNE-Loop (UNE-L) orders, Verizon's hot-cut performance would have to improve approximately 4400 percent. Such an improvement would be unlikely absent major changes to streamline the hot-cut process."[29]

Talk America currently serves approximately 24,000 access lines in New York. At the average monthly rate that Verizon performed hot cuts during 2001, it would take more than five months for Verizon just to convert Talk America's existing customer base from UNE-P to UNE-L. Of course, during the same period, Verizon would have to perform hot cuts to convert the customer bases of all other competitors now using UNE-P, as well as provision new service orders. Further, if Talk America were restricted from using ILEC switching in all of the markets where it operates, it would also have to convert its remaining approximately 220,000 access lines. Such a task would require the addition of considerable human resources by Talk America even to be completed within a multi-year timeframe, at a substantial cost that should be considered in any analysis of impairment.

Neither Verizon nor any other RBOC has demonstrated how this transition could be accomplished without completely disrupting the operations of competitors, creating massive service outages for competitors' customers, and essentially destroying the ability of their competitors to compete. Not only would competitors suffer if CLECs could not

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[27] *Id.*
[28] *Id.* at 4.
[29] *Id.*

longer serve customers via UNE-P, but customers would suffer as well. Because of the need to physically transfer loops from the ILEC port on the Main Distribution Frame to CLEC facilities in a collocation arrangement, a customer's line could be out of service, during which time the customer would not have access to 911 services, which is particularly unacceptable for residential subscribers for public safety reasons. Talk America does not believe that the public interest would be served by revising the unbundling rules in a way that will cause residential customers to lose their dial tone and access to 911 services when they seek to switch to a competitive carrier

Until the ILECs can develop a seamless, mechanized method of performing hot cuts, it is impossible to conclude that competitors who rely on UNE-P to provide competitive telecommunications services to residential customers would not be severely impaired in their ability to offer those services if UNE-P were no longer available. In fact, if effective residential competition is to develop, customers must be able to switch their local carriers as seamlessly as they can now switch their long distance carriers—with no interruption in service and without incurring large switching costs. Given current ILEC processes, UNE-P is presently the only provisioning method that can provide a seamless local service conversion. Only if and when the ILECs are able to develop affordable, mechanized hot-cut processes that provide the same level of transparency to the customer when they switch their local service to a competitive carrier (or back to the ILEC) should the Commission consider phasing out UNE-P.

AT&T has proposed an Electronic Loop Provisioning (ELP) method of transferring local customers from one carrier to another that it describes as being analogous to the existing PIC process used to change a customer's long distance provider and as eliminating the need for physical hot cuts. This process would require upgrades to the existing local network architecture at both the remote terminal and central office. Talk America supports this concept as a way to allow for the seamless transfer of large volumes of customers in the mass market from one local carrier to another—a result that must be achieved before the FCC should consider eliminating switching as a network element for CLECs serving mass market customers. Because numerous technical details would have to be considered in determining how best to achieve this result, Talk America recommends that the FCC establish an Industry Task Force to evaluate this issue, similar to the investigative process that has been used with respect to other technically complex issues before the Commission, such as the transition from the 800 NXX plan to the 800 database plan.

Beyond the issue of hot-cuts, other operational obstacles contribute to the impairment that CLECs such as Talk America would suffer without access to UNE-P. For instance, to provide service using their own or third-party switching facilities, a CLEC currently must lease space for and build out collocation cages within the ILEC central offices or, if the services are available, lease such space from a competitive collocation provider. This is both a costly and time-consuming requirement. Further, none of the RBOCs have produced information demonstrating that collocation space would be available in the central offices where CLECs who currently provide service via UNE-P would require such space. If collocation space is not readily available, CLECs will be materially impaired in their ability to provide telecommunications services without unbundled access to UNE-P. If it is available, the cost of leasing and building out the collocation space would likewise materially impair CLECs attempting to compete in the mass market where inadequate concentrations of customers exist.[30]

The technical obstacles that competitors would confront if they were required to provide service using their own or third-party switching rather than UNE-P have significant cost implications, which must also be considered in the impairment analysis. For instance, considering only the nonrecurring cost of hot cuts, Talk America estimates that it would incur costs of $840,000[31] just to convert its existing 24,000-line customer base in New York from UNE-P to UNE-L. In addition, if it were to continue serving every access line presently subscribed to Talk, the Company would need to lease collocation space in 402 central offices, at an estimated nonrecurring cost of approximately $3 million and additional monthly recurring charges of $746,000. Spreading the nonrecurring collocation costs over a 10-year period, the average monthly cost per line just for leasing collocation space for the 24,000 lines currently served would be $32.15. In most central offices, where Talk serves very few access lines, the average per line cost of collocation would be far higher than this overall average, and in the relatively few offices with higher line density the cost per line be less. As indicated in the following table, in New York Talk America serves less than 100 lines per central office in 92% of the central offices where Talk America-served access lines terminate. In 42% of the central offices, Talk America serves only 1-5 lines. The cost per access line

[30] The collocation obstacles could be mitigated if the FCC were to revise its rules to allow CLECs to combine loop and transport facilities on a DSO level to serve lines in central offices where the CLEC is not collocated.

[31] This estimate is based on an NRC charge of $35 per hot cut, which was recently adopted as a "promotional rate" by the New York Department of Public Service. However, the cost would be substantially higher (approximately $4.45 million) if this promotional rate becomes unavailable from Verizon and it reverts to charging the $185.54 rate that the NYDPS has stated is the Total Element Long Run Incremental cost to Verizon for performing a hot cut.

to lease and build collocation cages in these low-density offices would be extremely high, and could never be economically justified.

Number of Lines Served	Number of Central Offices	Cumulative Percent of Offices
1 - 5	167	42%
6 - 10	72	59%
11 - 25	72	77%
26 – 50	37	87%
51 – 100	23	92%
101 – 500	24	98%
501 – 1000	3	99%
1000+	4	100%
Total	402	

If the ILEC switching UNE were eliminated in its New York markets, Talk America would also need to install a switch or multiple switches to serve its existing customers, as well as local interconnection, transport and termination facilities to carry traffic from each of the 402 central offices to Talk's switch(es), and from the switch(es) back out to the ILEC and toll networks. All of these costs must be included in any analysis of impairment.

Talk America could mitigate its costs to serve New York customers using its own switching to some extent if it retained only the access lines concentrated in a few central offices, and discontinued service to all other customers. For instance, if the Company collocated in just the four central offices in New York with the highest concentration of lines (1000+), it could install a single switch, and would have lower collocation, interconnection, and migration costs, reducing both its up-front and ongoing recurring costs. Considering the modest volumes of customers Talk America currently serves even in these central offices, however, impairment may still exist at this time with respect to these offices. Moreover, in order to achieve the lower costs, Talk America would have to discontinue service to nearly 12,000 access lines in the other 398 central offices, leaving those customers without the competitive choice they made when they selected Talk America. Such an outcome demonstrates one of the major problems in eliminating ILEC unbundling obligations without an extremely detailed market-by-market impairment analysis. Where the cost to provide service becomes prohibitive without access to ILEC UNEs, CLECs will be forced to discontinue their service to current customers and restrict their offerings to new customers. Thus, rather than promoting competition and working to erode the ILECs' monopolies, such a policy would result in a retraction in competition and a strengthening of those monopolies, contrary to the goals of the Act.

4. Transitional Issues

Even if Talk America could overcome the operational and cost obstacles discussed above and convert some or all of its access lines from UNE-P to UNE-L combined with self-provisioned or third-party switching, significant transitional issues would have to be addressed to convert its existing customer base, particularly while the current manual hot cut process remains the only option for the conversion. Talk America believes that the following steps and timeframes would, at a minimum, be required, to convert only a portion (e.g., lines served from the four highest density central offices) of its customer base within a single state like New York, coordinating with a single RBOC.

- Locate and lease suitable building space for installation of switch (2-3 months)
- Purchase and install switch (6 months)
- Install transmission facilities from collocation facilities to the switch (one month)
- Develop and coordinate parameters for a test with the RBOC to convert a small number (e.g., 50) of test lines – (2-3 weeks)
- Transition remaining 12,000+ lines in four central offices in incremental "projects" (18-24 months, depending on number of lines that can be hot cut per project)

In total, Talk America estimates that it would take approximately 27 to 33 months for the transition of approximately 12,000 access lines that it currently serves out of four Verizon central offices in New York. Talk America believes that these projected timeframes, if anything, are optimistic and reflect an assumption that Verizon and Talk America are able to commit substantial human resources to the project. Comparable transitional processes would be required in each of the other RBOC service territories where Talk America currently has customers. For Talk America to perform the transitions simultaneously in all of its markets would require a substantial increase in its current resources in virtually all areas of its business, including ILEC account management, operations, information technology, regulatory, and customer service. These additional resources would impose significant costs on the company, which would need to be considered in any cost/benefit analysis of the build vs. lease decision, and should likewise be considered in any analysis of impairment.

5. Cost Effectiveness of Existing Switched-Based Competition

The RBOC argument that the existence of competitive switching facilities in some locations demonstrates non-impairment is also deeply flawed in that it fails to consider whether the deployment of those switching facilities was, in fact, an economically efficient and financially viable decision. In most cases, it apparently was not. For instance, a recent article in the Washington Post noted the fallout from the "Field of Dreams," facilities-based entry strategy that occurred in the mid 1990's and into 2000: "About 500,000 people have lost their jobs. Dozens of companies have gone bankrupt. As much as half a trillion dollars in investments have evaporated."[32] The article further

[32] Peter S. Goodman, *Telecom Sector May Find Past Is Its Future – Giant Phone Companies Offer Stable, Well-Funded Option*, *washingtonpost.com*, p. A01 July 8, 2002.

noted the disparate impact of the telecom industry woes on start-up competitors, relative to the incumbents: "Above a landscape littered with bankrupt start-ups, the giants continue to rule – Verizon Communications Inc., SBC Communications Inc. and BellSouth Corp., the local telephone monopolies carved out of the breakup of AT&T Corp."[33]

Given that many of the CLECs who installed switches in an effort to compete using a facilities-based entry strategy ultimately found themselves with excessive costs and inadequate demand, forcing some into bankruptcy, the mere existence of those switches in the market cannot legitimately provide evidence of non-impairment from the withdrawal of switching as a required UNE. To the contrary, the financial failure of many facilities-based carriers suggests that such a strategy has not been cost effective or economically efficient and that another strategy is called for if the goals of the Telecommunications Act are to survive the current industry shakeout.

The history of competitive development in the long distance market provides a blueprint for that strategy. There, most competitors began as resellers of AT&T services, building their customer bases until they developed sufficient customer densities to justify investment in alternative switches and transmission facilities. Further, under the FCC's access rules developed to facilitate and stimulate competitive entry into the long distance market, competitors were given a 45% discount on their access costs relative to those paid by the incumbent, providing prospective entrants with strong incentives to enter the market and provide competitive choices to customers. Talk America believes that a similar approach is needed to stimulate competition in the residential local markets. Competitors should be allowed to build their residential customer bases through the use

[33] *Id.*

of ILEC-provided UNE-P, as required by the Act, until they attain sufficient size and customer density and have sufficient access to capital to justify facilities investment in specific markets. Companies attempting to compete in the currently underserved residential market should be given every incentive to offer competitive services to residential customers throughout the country, in both high and low-density areas, in order to bring the benefits of competitive choice to consumers in the mass market.

6. Alternative Competitive Business Models

The RBOCs claim that CLECs are serving approximately three million residential lines using their own switches, thus dispelling any argument that CLECs are impaired without access to ILEC switching and the UNE-Platform.[34] They acknowledge, however, that the CLECs who serve these lines through their own switches have done so "either by expanding the services on their existing large-customer-focused networks, or by expanding the geography of their existing broad-customer-based networks into adjacent territories."[35] Thus, these examples of switched-based CLECs offering service to residential customers is limited to: (1) CLECs who entered the business with a large business customer focus; or (2) ILECs who have expanded their existing networks into other service territories (*e.g.*, Alltel). One cannot conclude from these limited examples that competitors like Talk America, who chose to enter the market initially with a residential customer focus and without the advantage of incumbency in adjacent service territories, would not be impaired attempting to compete in those same markets without access to the ILEC switching element. Nor does the existence of some switched-based

[34] The three million line figure is suspect, as it appears to rely upon telephone numbers that CLECs have added to the E911 database that the RBOCs *believe* to be residential telephone numbers, a fact that is exceedingly difficult to verify.
[35] UNE Fact Report 2002 at II-10.

residential competition suggest that any competitors—including those who may be offering service to residential customers in certain areas utilizing their own switches—would not be impaired without access to ILEC switching if they sought to enter other markets where they currently do not have switching facilities.

The RBOCs' argument on this point is rather ironic, because it implies that only the "cream-skimming" CLECs, (who the RBOCs have historically disparaged) or incumbent LECs should be permitted to compete for residential customers, because only those two types of carriers have been able to serve residential subscribers using their own switches. Under the RBOC argument, other kinds of competitive carriers will be excluded from the residential market, because they will be denied access to ILEC switching and UNE-P.

Likewise, the RBOCs' contention that inter-modal competition from cable companies demonstrates a lack of impairment is equally flawed. The RBOCs have not pointed to any evidence demonstrating that cable companies have been able to provide an efficient and effective competitive alternative to the traditional wireline telecommunications services that are utilized by virtually all residential consumers.

The Telecommunications Act intended to advance widespread residential competition by carriers with a variety of historical circumstances and business plans, including those, like Talk America, who chose from the outset of their entry into the local market not to compete for large business customers, but to instead offer competitive telephone services to residential and small business customers through a UNE-P entry strategy, bringing competitive choice to the mass market. The Commission should not adopt a change in policy that would impair the ability Talk America and other similarly situated companies to compete for residential and small business subscribers, merely because other types of competitors serving entirely different segments of the market might not be impaired.

E. Natural Monopoly Test for Impairment

One of the bases for the D.C. Circuit Court's remand of the FCC's *Local Competition Order* was its conclusion that, "the Commission relied on cost disparities that, far from being any indication that competitive supply would be wasteful, are simply disparities faced by virtually any new entrant in any sector of the economy, no matter how competitive the sector."[36] Although the Court did not mandate a specific type of cost analysis, it's Opinion suggests that the FCC should consider whether an element has cost characteristics that render it a natural monopoly, and therefore a facility that would be wasteful or "unsuitable" to duplicate.

For instance, in examining the FCC's evaluation of local switching costs, the D.C. Circuit noted the Commission's conclusion that "there are economies of scale in switches, ...and that it is cheaper to buy a 20,000-line switch than four increments of 5000 lines each...The Commission refers explicitly to a CLEC's probable inability to enjoy scale economies comparable to ILECs' 'particularly in the early stages of entry.'"[37] The Court opined that this cost analysis was too broad because "average costs are necessarily higher at the outset for any new entrant into virtually any business,"[38] and the FCC did not focus on "the presence of economies of scale 'over the entire extent of the market,'"[39] the classic definition of natural monopoly. Notably, the Court did not find

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[36] *USTA v. FCC* at 426.
[37] *Id.*
[38] *Id.*
[39] *Id.*

that any of the network elements designated for unbundling by the FCC failed to satisfy this cost standard, only that the FCC did not adequately consider the standard in designating them.

In reevaluating the impairment test in light of the D.C. Circuit Court's admonition, the FCC should recognize the unique historical circumstances that gave rise to the cost advantages that persistently favor incumbent local exchange carriers over new and prospective entrants. While it is true that in any industry where production inputs include a fixed cost component (e.g., equipment costs) a new entrant with little or no initial demand for his product will face higher average cost than an incumbent, the telecommunications industry cannot realistically be regarded like "any business." The cost advantages enjoyed by incumbent LECs stem from nearly a century of the ILECs' government-protected monopoly control of the local exchange networks, which enabled them to build ubiquitous integrated networks serving nearly every household in the nation using investment that was virtually guaranteed recovery[40] by ratepayers through the historical return-on-rate base ratemaking process.[41] As they considered investing in loops, switches, transport facilities and other network components, the ILECs did not have to be concerned about whether they could generate demand and, thus, revenue for their services sufficient to cover their average costs and produce a profit, because they had a guaranteed customer base (being the "only game in town") and were allowed under regulation to charge rates that fully recovered all "prudently" incurred costs. Now, as

[40] Under traditional ratemaking methods used prior to "price cap regulation," to the extent the regulated LECs could convince state regulators that their investments were prudently incurred, their costs, including a reasonable return on investment, were historically included in regulated retail rates established by those commissions. Even under the more recently introduced price cap method of retail rate regulation, some LECs have been able to convince state commissions to raise the caps to provide for full recovery of the LEC's costs.

competitors seek to enter these historically monopolistic markets, the incumbents retain the embedded network facilities that were funded by ratepayers over the years, much of which remains used and useful in providing telecommunications services.

These historical circumstances cannot be ignored in considering the cost hurdles that competitive carriers now face when they attempt to compete against the incumbent LECs in the local exchange markets, particularly for residential customers. These hurdles are not like those that newcomers confront in "any business," because the incumbents in non-regulated industries did not enjoy the benefits of government protection and revenue assurance as they built their businesses, as the ILECs did. In fact, the Supreme Court recognized the unique obstacles facing prospective entrants into the local markets, resulting from the incumbent's control of the local network:

> It is easy to see why a company that owns a local exchange (what the Act calls an "incumbent local exchange carrier," 47. U.S.C. §251(h)), would have an almost **insurmountable competitive advantage**...A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses.[42]

These competitive advantages were not the result of the outstanding business acumen of the ILECs over other firms operating in a competitive marketplace, but were rather the result of a regulatory system that enabled the ILECs' to invest in ubiquitous networks with very little risk, by protecting them from entry and ensuring their recovery of prudent costs. The unbundling provisions of the Act were intended to help competitors overcome these "insurmountable" cost advantages by requiring the ILECs to

[42] *Verizon v. FCC* at 1662.

lease to the competitors elements of their ratepayer-funded, government-protected monopoly networks at reasonable rates whenever competitors would be impaired in their ability to offer service without access to those elements.

In considering whether individual network elements have natural monopoly cost characteristics that would make their duplication by competitors wasteful from society's perspective, the FCC should consider the totality of costs that a competitor would have to incur to substitute that element with alternative facilities. For example, while the average cost of local "switching," as a separate ILEC network element, may not decline throughout the entire range of output in all markets (but may in some), a competitor who had to replace ILEC switching with self-provided or third-party switching would incur far more than just the cost of the switch itself. As noted previously, a competitive carrier would also incur substantial fixed and ongoing operational costs to collocate in all of the ILEC central offices where customer lines terminate, costs for transport facilities needed to consolidate the traffic from the various central office collocations to the competitor's switch and to route the traffic back to the ILEC's and the toll networks, as well as land and building costs to house the switch. Additionally, for a CLEC with existing customers that would need to be transferred from UNE-P to UNE-L, the CLEC would incur upfront nonrecurring charges from the ILEC as well as substantial internal costs for additional resources that would be needed for the transition. All of these costs should be included in an impairment analysis when comparing the ILEC's switching costs to the cost that would be incurred by a CLEC to replicate that switching capability in order to provide service. If the impairment analysis considers instead only whether the average cost of the switching equipment itself declines throughout the entire range of market demand, the cost to competitors and, therefore, the extent to which they will be impaired without access to ILEC switching, will be grossly understated.

IV. CLEC Incentives to Transition to Facilities-Based Competition

A. Non-Cost Incentives

The RBOCs suggest that CLECs will always prefer leasing UNEs to building facilities, as long as UNEs are available at TELRIC-based prices. However, this argument completely ignores the non-cost incentives that CLECs have to reduce or eliminate their dependence on the incumbents for the critical inputs into the telecommunications services they provide or seek to provide. As Talk America described at some length in its Initial Comments, CLECs continue to endure discriminatory and anti-competitive behavior by the incumbent LECs, which dramatically affects their ability to compete successfully against those LECs.[43] Much of this behavior is possible only because the incumbents control the underlying facilities and support systems that CLECs must rely upon to provide telecommunications service to their customers.

For instance, the line loss reporting problems that Talk America and other CLECs have experienced, particularly in SBC's Ameritech operating region,[44] affect only CLECs who rely on UNE-P as a means of competing. ILECs are required to provide reports to CLECs that indicate when a customer has disconnected a CLEC line provisioned by the ILEC using UNE-P, since the CLEC has no other means of knowing when such a disconnection takes place. The RBOCs, however, have often provided reports of line loss days or weeks after the line has been disconnected, or not at all. These reporting failures severely impede a CLEC's ability to properly serve and bill its customers and create

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[43] *See* Initial Comments of Talk America at 18-21.
[44] *Id.* at 19.

substantial customer dissatisfaction, as well as regulatory problems. In considering whether to remain on Ameritech's UNE Platform or invest in its own switching facilities, the seemingly intractable line loss reporting problem that Talk America has experienced would weigh significantly in the decision, creating a strong incentive for Talk America to choose in favor of deploying its own facilities.

The RBOCs display a profound ignorance or gross misunderstanding of their competitors' business when they argue that CLECs who utilize UNE-P would prefer to remain forever captive to the incumbent's facilities, rather than invest in their own, as long as UNEs remain available. While the direct costs of leasing UNEs versus building facilities will always be a significant factor in the lease/build decision, there are many other factors that create strong incentives for CLECs to move as quickly as possible to their own facilities so that they can reduce their dependence on their largest and most formidable competitors. The ILEC's position as the vendor of necessity causes every UNE-P CLEC concern and creates an undesirable, long-term business dependency.

B. Cost and Operational Incentives

While CLECs who currently rely on UNE-P as an entry strategy have strong non-cost incentives to reduce their dependence on ILEC facilities by building their own or leasing from independent third parties, the realities of the current financial markets, as well as sound business practice, dictate how and when they can begin that transition. It is critically important for the Commission to understand that, given the current state of the capital markets, CLECs are not in a position to raise and commit capital to such investments unless they are shown to be economically viable in the very near future. If they are not, and the Commission nevertheless eliminates the ILEC requirement to offer

UNE-P, CLECs like Talk America will lose their ability to provide service to existing and prospective customers (clearly demonstrating impairment), and customers will likewise lose the competitive choices they currently have available as a result of the UNE-P requirement.

As explained in Talk America's Initial Comments, the only way to viably promote facilities-based competition for the residential/small business market is to allow CLECs to continue to employ the UNE-P entry strategy until they can obtain sufficient customer concentrations in their markets to make self-provisioning of switching facilities economically justified. Currently, UNE-P is the only provisioning method that provides for a relatively seamless transfer of the customer from one carrier (generally the ILEC) to another (the CLEC), because it does not require any physical reconfigurations of the customer's service. A transparent customer transfer is especially critical when attempting to attract residential customers, who have service characteristics distinct from large, multi-line business customers that must be recognized when considering their ability and propensity to switch their local service.

For instance, unlike residential subscribers most multi-line businesses have defined operating hours (*e.g.*, 8 to 5) and are closed on weekends, making it feasible to schedule a hot cut either after hours or during a weekend, thereby avoiding customer disruption and inconvenience during the period when their service is interrupted to facilitate a switch in carriers. Further, because the service transfer can usually be performed after hours, a loss of 911 access during the hot cut is generally not a significant concern. In contrast, residential customers have widely varying scheduling requirements, and may be unwilling or unable to suffer any interruption in dial tone, due to general inconvenience as well as a loss of access to 911. A residential customer's unwillingness to suffer the inconvenience of a switch in local carriers is heightened when the difference in retail price between the incumbent and the competitor is not sufficiently large to overcome the inconvenience. Margins are typically much smaller in the residential market than in the business market, making it difficult for competitors to offer discounts sufficiently below the incumbent's rates to attract customers, even with a seamless transition, much less without one.

In addition to customer service-related differences between residential and large business customers that affect the feasibility of self-provisioning switching, there are significant cost differences as well. Because residential customers typically have only one or two lines, it is far more labor intensive and costly on a per-line basis for competitors to convert residential lines via the hot cut process than it is to convert multi-line business customers using that process. Currently, the most efficient and the least disruptive means of switching residential lines from an ILEC to a CLEC switching platform would be to first provision customer lines through UNE-P and then, once the CLEC has a sufficient volume of lines in a particular central office, coordinate a mass "project" hot cut for all of the lines through a mechanized process that avoids or greatly minimizes loss of dial tone. With the existing manual hot cut process, however, even this approach imposes risks of service disruption that are unacceptable in the residential market. A mechanized process to switch customers from one local carrier to another, such as the ELP process proposed by AT&T, would substantially reduce these risks and improve the efficiency of the switching process.

Unless a CLEC serves a sufficient concentration of lines in a particular central office, the high capital costs of using their own switches will preclude them from competing. As Talk America noted in its Initial Comments in this proceeding, the only way to successfully compete in the relatively low-margin residential and small business market is to attract and retain a large customer base. To accomplish that, Talk America has employed mass marketing techniques (*e.g.*, direct mail, telemarketing, television advertising, etc.), which has resulted in a widely disbursed customer population, as illustrated by the distribution of Talk's customers in New York across 402 different central offices previously discussed. Unlike facilities-based CLECs who initially deployed switches to serve large business customers and then expanded their customer base in the same area to include residential subscribers, Talk America does not currently have a "core" base of customers in a concentrated location, but instead serves varying numbers of access lines—sometimes only one or two—in a large number of separate wire centers.

It is impossible to economically justify investment in collocation, interoffice transport, and switching to serve a small number of residential lines in a single central office, particularly if there is little likelihood of substantial growth in lines served from that office within the immediate future. Consequently, in considering a transition from UNE-P to facilities-based switching, a CLEC such as Talk America would need to evaluate the location-specific (*e.g.*, by CLLI code) demand for its service and the total cost to serve each location. If the line density were insufficient to justify the switching, collocation, and other investment that would be required to replace UNE-P, the company would not allocate investment to that market. Accordingly, in the absence of the UNE-P option, Talk America would abandon such markets, typically less densely populated areas, and these customers would lose the benefit of the competitive alternatives they now have.

Talk America has commissioned a study of the cost of self-provisioning switching in three markets where the company currently provides residential service. The results of that analysis are intended to demonstrate, given current UNE costs, retail prices, and the costs of self-provisioned switching, the level of demand (number of lines) at which it would be economically justifiable for the company to convert from UNE-P to UNE-L and self-provided switching. We will provide the results of this analysis to the Commission when it has been completed.

V. Recommendations

The FCC should modify its rules to establish clearly-defined standards to be applied by states in evaluating ILEC unbundling requirements, similar to the detailed rules adopted for application of the TELRIC pricing methodology. The state regulatory commissions should conduct market-specific analyses to establish state-specific unbundling requirements following the FCC-established guidelines for determining impairment, similar to the process that has been used by the states to develop company-specific and market-specific UNE prices based on FCC rules.

To avoid disruptions in the current availability of UNEs, which could severely undermine the CLEC industry and the competition that has developed to date, the FCC should require ILECs to continue to provide UNEs currently subject to unbundling requirements (including the UNE-P combination), pending the outcome of state-specific proceedings. Specifically, the following elements included in the UNE Platform should remain available to competitors, unless and until a market-specific analysis determines that CLECs who employ the platform would not be impaired, and competition would not suffer, without unbundled network access to specific components of the platform:

1) loop (including the Network Interface Device)
2) local circuit switching, including all features and functionality of the switch
3) common and shared transport
4) databases (e.g., 911, directory)
5) operational support systems
6) signaling

In establishing guidelines for states to follow in determining whether these and other elements should remain subject to unbundling requirements on a market-by-market basis, the FCC should include standards related to the operational and economic obstacles that could impair CLECs without access to the elements. The standards for demonstrating that impairment no longer exists with respect to a particular element should require, at a minimum, the following findings:

1) With respect to the local switching element, a determination that the incumbent LEC serving the market has a demonstrated ability to convert the existing customer base of all competitors using the ILEC switching facilities to alternative switching facilities through a mechanized process without any unreasonable disruption to the service of the CLECs' customers, including their ability to access 911. On an ongoing basis, the ILEC likewise must demonstrate

the ability to perform hot cuts for new customers via a mechanized process (e.g., ELP) without any disruption in the customer's service, comparable to the switching process now in place in the long distance market.

2) With respect to the local switching element, a determination that sufficient collocation space is available in all central offices where CLEC's who would otherwise rely on CLEC switching either currently serve or seek to serve customers. Alternatively, rules should be amended to eliminate the collocation requirement by allowing CLECs to provision lines terminating in central offices where they are not collocated through the use of a combined DS0-level loop/transport combination.

3) For all elements, a determination that competitive alternatives are offered in the relevant market for that element at prices no higher than the TELRIC prices charged by the ILEC, and that such competitive prices are likely to be sustainable once the ILEC withdraws the unbundled element from the market. The mere presence of facilities installed by non-ILECs should not be sufficient to meet this standard for competitive alternatives.

If, based on a market-specific analysis of impairment, a state determines that a UNE should be removed from the list of required unbundled elements in a specific market, the FCC rules should require a transition period of **at least** 24 months to enable CLECs who currently utilize that element to replace it with either its own facilities or third-party alternatives. Procedures should be available for affected CLECs to request and receive additional time for the transition, if they demonstrate to the state commission that they are unable to complete the transition within 24 months due to factors beyond their immediate control (e.g., inability of the ILEC to perform functions required for the transition.)

VI. Conclusion

In reevaluating and redefining the ILECs' unbundling obligation, the FCC should be mindful of the Supreme Court's determination that the Act's unbundling requirements were intended to give "aspiring competitors every possible incentive to enter local retail telephone markets,"[45] in order to "uproot the [ILEC] monopolies."[46] Any change to the current unbundling requirements should not sacrifice the modest competitive gains that have been made to date, nor preclude future competitive inroads into the ILEC monopolies. Were that to occur, the objectives of the Act, as plainly interpreted by the Supreme Court, would be subverted, to the detriment of consumers and the public interest at large.

In light of the recent D.C. Circuit Court decision in *USTA v. FCC,* the Commission's Triennial Review of the unbundling obligations that should be imposed on ILECs pursuant to the Act requires a more granular market-specific analysis of CLEC impairment, as well as the important non-impairment standards identified in the FCC's 1999 *Local Competition Order*. Such a granular analysis would be appropriate even in the absence of the D.C. Circuit Decision, when considering whether to eliminate ILEC unbundling requirements with respect to any existing UNEs. Such an analysis requires

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[45] *Verizon v. FCC* at 1661.
[46] *Id.*

substantial participation and decision-making authority by state regulators, who are in the best position to determine market-specific impairment.

Respectfully submitted,

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DATE: July 17, 2002